



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Number: **201120035**
Release Date: 5/20/2011

Date: February 21, 2011

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:
1041

Tax Years:
All Years

UIL: 501.03-03

Dear :

This is our final determination that you do not qualify for exemption from Federal income tax as an organization described in Internal Revenue Code section 501(c)(3). Recently, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law and rationale, and gave you 30 days to file a protest. Since we did not receive a protest within the requisite 30 days, the proposed adverse determination is now final.

Since you do not qualify for exemption as an organization described in Code section 501(c)(3), donors may not deduct contributions to you under Code section 170. You must file Federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, you should follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

In accordance with Code section 6104(c), we will notify the appropriate State officials of our determination by sending them a copy of this final letter and the proposed adverse letter. You should contact your State officials if you have any questions about how this determination may affect your State responsibilities and requirements.

Letter 4038 (CG) (11-2005)
Catalog Number 476328

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your Federal income tax status and responsibilities, please contact IRS Customer Service at 1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Holly Paz

Holly Paz
Director, Exempt Organizations
Rulings & Agreements

Enclosure
Notice 437
Redacted Proposed Adverse Determination Letter
Redacted Final Adverse Determination Letter



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Date: September 21, 2010

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

LEGEND

B = State
C = Church
D = Denomination
E = International Church
F = Trust Settlor/Donor
G = Donor
H = Family Trustee
J = Trustee
K = LLC
L = Individual Loan
M = LLC
N = Former Partner
O = Individual Recipient
P = Individual Recipients
Q = Real Estate
R = Real Estate
S = Real Estate
T = City, State
U = City, State
V = Trustee/Pastor
W = Church
Y = Program
x dollars = Amount
y dollars = Amount
z dollars = Amount
bb dollars = Amount
cc dollars = Amount
dd dollars = Amount
ee dollars = Amount
ff dollars = Amount
gg dollars = Amount
hh dollars = Amount
jj dollars = Amount

UIL Nos.:

501.03-03
501.03-30
501.30-01
501.30-02
501.32-00
509.01-00

kk dollars = Amount
 ll dollars = Amount
 mm dollars = Amount
 nn dollars = Amount
 pp dollars = Amount
 qq dollars = Amount

Dear :

We have considered your application for recognition of exemption from federal income tax under Internal Revenue Code section 501(a). Based on the information provided, we have concluded that you do not qualify for exemption under Code section 501(c)(3). The basis for our conclusion is set forth below.

ISSUES

1. Do you qualify for exemption under section 501(c)(3) of the Code?
2. If you are exempt, are you a supporting organization as described in section 509(a)(3) of the Code?

FACTS

You are a trust created under a trust document in the State of B. You were funded with an initial donation of y dollars made by F. Donations totaling x dollars were made to the trust by F and G, husband and wife, during the four year period.

You are requesting exemption as a Type III Supporting Organization under section 509(a)(3) of the Code. Schedule D of your application states that you will be operated in connection with your supported organization. Schedule D does not include the name of your supported organization(s); however, your trust document provides in Part 2.1.2 that your primary supported charitable organization is the W in T, known as C, a church. The trust document also states that you will support other churches and their activities that are affiliated with D, a denomination.

Part 1.2 of the trust document states that the "Foundation Trust is organized to support Christian religious ministries. The primary mission of the supported organization is to preach, teach and demonstrate the Gospel of Jesus Christ through various humanitarian acts such as feeding, clothing, educating and providing shelter for children, widows and orphans locally that may otherwise not get such needs satisfied if not for the funding by this Foundation Trust. It is the goal of the Trust to operate within the church community in any geographical area in which the Trustees reside."

Part 2.1.2 states that the primary supported charitable organization is W in T, known as C, a church. The document also states you will support other churches and their activities that are affiliated with D, a denomination.

Part 2.1.3 provides for replacement organizations if the specified supported organization ceases to exist or becomes a non-qualified recipient. The document also states, "the trustees in their

sole judgment may replace any organization which fails to promote the purposes of the Trust."

Part 2.2.1 states that the trust will extend financial aid or assistance to qualified charitable organizations.

Part 2.3 defines the term charitable organizations to mean organizations in the United States or in a foreign country and qualifying under the Internal Revenue Code as organized and operated exclusively for charitable purposes.

Part 3.0 identifies the trustees, stating that the number of trustees shall never be less than three, the majority of whom cannot be disqualified persons. In addition, at least one trustee must be appointed by the supported organization. There are three classes of trustees, 1) charity trustees, 2) family trustees and 3) other non-disqualified trustees. Charity trustees will consist of at least one trustee appointed by the primary supported organization. The initial charity trustee is V, Pastor. Family trustees will consist of at least one person from the class consisting of the settlor, F and his family. The initial family trustee is H with G as successor family trustee. In addition to the family and charity trustee there will be one or more additional trustees who are not disqualified persons as defined under section 509(a)(3)(C) of the Code.

Part 3.2.3 states that all decisions, actions and powers of the Board require the approval of a majority of the trustees.

Part 3.4 states that the Board may remove a trustee by a vote of the majority of the trustees so long as at least one of the family/donor trustees votes in favor of such removal. The trustee subject to removal is not permitted to vote on the matter.

Part 5.1.1 states that the trustees may make payments or distributions of all or any part of the income or principal to states, territories, or possession of the US, any political subdivision thereof, or to the U.S. or District of Columbia for charitable purposes.

Part 5.2 provides that upon termination of the trust all funds and accounts shall be transferred to a new charitable organization selected unanimously by the trustees with a function and purpose similar to yours.

Part 7.1.1 states that no principal or income, however, shall be loaned, directly or indirectly, to any trustee or to any party, corporate or otherwise, who has at any time made a contribution to this trust, nor to anyone except on a basis of an adequate interest charge and with adequate security in violation of any law or the IRC.

A Restated Trust Agreement was submitted by fax. Part 2.1.2 has been revised to read "Primary Supported Charitable Organizations W in T known as: C [a church] affiliated with E [an international church]." Other provisions were deleted or revised that are not relevant to the issues involved herewith.

Your Form 1023 lists your trustees as J, V and H. Schedule D states that you establish the "operated in connection with" responsiveness test because one or more members of the governing body of the supported organization also serve as your trustees. Furthermore, as a result the supported organization has a significant voice in your investment policies, in the making and timing of grants and in otherwise directing the use of your income or assets

because one of the W's trustees is on the Board of the supported organization. Also, the form provides that V is the Pastor of W in U. As to the integral parts test, you did not state how much you provide annually to your supported organization or the total annual revenue of the supported organization. Finally, you indicated that your funds are earmarked for support of a particular program of the supported organization, "to promote the gospel of Jesus Christ through various charitable acts towards children, widows and orphanages that would otherwise not be met or accomplished but for our funding."

Your application states that your funds distributed to the supported organization are earmarked for a particular program; however, the name of the program was not initially specified. You stated in a letter that you provide more than 50% of the funding of the earmarked program during the relevant time. Also, you stated in another letter that the operational costs of the supported program were less than 50% of the disbursements from the trust and that disbursements were more than 10% of the annual cost of the program. You listed support for Y, the earmarked program, by the trust in the amount of z dollars over a three year period. You also submitted a copy of a letter from the supported organization describing the earmarked program and stating that more than bb dollars has been accumulated for the project as of a certain date. Finally, you submitted another letter written to your attorney by the supported organization stating that the funds raised for the earmarked program was cc dollars during a two year period.

Copies of your checking account statements and cancelled checks indicate that you made distributions totaling dd dollars over a three year period to your supported organization. Also, you made a distribution to P, an individual, as well as three separate payments to O, an individual, over a three year period as Christmas gifts. Copies of your filed Forms 990 for the three year period were submitted. One Form 990 states that you made two payments to C for a "humanitarian act" and "financial assistance." The second Form 990 states that you provided support to C in the amount of ee dollars. The third Form 990 states that you made payments totaling ff dollars to the C. Information obtained from your checking account statements and cancelled checks indicate that you made two distributions, one to a fund established to pay the cancer related medical bills of a child and two to another person affiliated with C as an apparent Christmas gift (notation on check "Merry Christmas").

You stated that you meet the Group 1 criteria (from the Section 509(a)(3) Type III Guidesheet) because the Supported Organization has confirmed that the criteria for Group 1 is met, which is all that is required. In addition, you stated that the gifts of the trust were very significant at the beginning of the program and have become less so. Also, you are not seeking to rely on the Group 2 criteria (supporting an earmarked program) for qualification. Finally, you stated that Y, the earmarked program, is now an integrated part of the church ministry as evidenced by the submitted brochure from the supported organization.

You submitted a schedule of loans made by you to others. Three loans were made to K, the LLC owned by F the settlor/donor, totally pp dollars and all three loans have been repaid or retired. One loan was made to M, the LLC owned by F the settlor/donor, and it was recently paid in full on December 31, 2009. One loan was made to L, an individual, and it was repaid during the same year it was issued. You also submitted promissory notes for the loans, three of the notes were unexecuted. The note for the loan to L, an individual, states that it is payable in 7 days. Four of the notes were secured by real estate owned by F, the settlor/donor, located at Q, R and S. Three of the notes contain the same terms, payment thirty days of demand after

twenty-four months from the date of the note and an interest rate of 8% with interest paid quarterly. The loan that was recently paid in full had terms of payment thirty days of demand after twenty-four months from the date of the note and an interest rate of 8% with interest paid semi-annually. According to the recorded deed of trust securing the note, the promissory note was due and payable on January 31, 2009. Finally, you state that two of the loans were made directly to F, the settlor/donor.

You stated that the loans are arm's length transactions since they are secured and the borrower pays a rate of interest that reflects the market at the time the loan was made. You also stated that the loans were made so that you could "receive interest income greater than the rate of return that was available from a bank or other financial institution." Finally, you stated that the trustees approved the loans. You submitted copies of your Board meeting minutes. The meeting involved only changes made to the Trust Agreement and the adoption of two resolutions. One resolution provides that the trustees will not make loans to any disqualified party, no loans shall be made in violation of the trust terms and that all outstanding loans shall be collected in the ordinary course. The second resolution states that no unsecured loans shall be made and the Board will keep regular minutes of its joint deliberations and decisions regarding trust operations. Handwritten notes from four other meetings were also provided. The handwritten notes were not signed and included one line statements for three of the meetings and a three line statement regarding the fourth meeting. Three of the notes covered approval of unspecified loans as well as the statements that all loans would be fully secured. The fourth set of notes involved the approval of collateralized loans along with the following statement, "F is entering into a new joint venture with N [an individual] and prior loans given will be retired in the process."

You submitted information indicating that interest has been received by you on the various loans that you have made totaling gg dollars. You submitted a schedule of interest payments for the loan with K, the LLC owned by F the settlor/donor, indicating that you received four payments. Your checking account statements show deposits corresponding to three of the payments; the first payment was not deposited. You indicated that the loan with L, an individual, was negotiated by H, family trustee, and was repaid per its terms; however, the check was not deposited when received. L, an individual, has no relationship with any of the board members and was referred to the trust by F, the settlor/donor, as a business acquaintance. The loans were made as the best method of producing income as the actual cash rate of return reflects cumulative income on the average trust assets for the two years that gifts were held and invested to produce an annual rate of return 6.4% on loans bearing an 8% rate of return. The trustees resolved to make no further loans and liquidate/collect the last loan per its terms or sell the loan. The loan with M, the LLC owned by F the settlor/donor, was recently paid in full. However, interest payments were not received semiannually and were less than required by the terms of the loan. Furthermore, the loan with M was repaid 11 months late.

You stated that evidence of the notes arm's length status is found by examining case law which establishes what evidence the court considers in total. Furthermore, you stated that the relevant case law reflects the adherence to the following criteria as it relates to loans made by any trust to a donor or affiliated entity and specifically to the loans made by you. You stated the loans were issued at above market interest rate, served the purpose of providing current income, no substantial part of the foundation's corpus or income was involved in loans made for the purpose of diverting its corpus or income from exempt purposes, a number of loans were secured with substantial collateral, the terms of the loan were not better than the individual

could have obtained from a bank and the borrower would not have had difficulty obtaining financing elsewhere, the borrowers were creditworthy and did obtain other secured and unsecured loans from banks, taxable income and net worth of borrower was substantial in relation to the amount borrowed, all loans were sufficiently secured and at rates of interest sufficiently unfavorable to the borrower and the interest has been paid to date and all other notes have already been retired.

You provided additional information regarding the loans made by the trust. The loans made to K, the LLC owned by F the settlor/donor, and M, the LLC owned by F the settlor/donor, were used to purchase or to refinance the loans to purchase the property. The property used to secure the loans was listed along with the fair market value and equity in each piece of property. Other investments were considered by the trust including mortgages, T-bills, stock market, and bank CD's, and each was not pursued due to either volatility or a low rate of return. F, the settlor/donor, and N, an individual, entered into agreements through K, the LLC owned by F the settlor/donor, and M, the LLC owned by F the settlor/donor, to develop two parcels of land. F secured the land using two short term notes from a bank and the trust.

Bank statements and cancelled checks for the trust were submitted by you. The statements provided the following information:

Total donations	x dollars	
Supported Organization received	dd dollars	7.59 % of Total donations
Accounting/Legal fees	hh dollars	
Loans	jj dollars	112 % of Total donations
Unexplained withdrawal then re-deposited	kk dollars	
Interest earned on four loans	ll dollars	3.28 % of Total donations
Loan initially outstanding and recently paid in full	mm dollars	
85% should have been distributed, 63% was distributed	nn dollars	
Bank Account Balance	qq dollars	

A substantial activity of the trust has been the making of loans as illustrated above.

ISSUE 1 - IRC 501(c)(3)

Law

Section 501(a) of the Code provides, in part, that organizations described in section 501(c) are exempt from federal income tax. Section 501(c)(3) of the Code describes, in part, an organization which is organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purpose, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 501(c)(3) of the Code provides, in part, for the exemption from Federal income tax organizations organized and operated exclusively for charitable, religious or educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the Regulations states in order to qualify under section 501(c)(3) of the Code, an organization must be both organized and operated exclusively for one or more exempt purposes. If an organization fails to meet either the organizational or operational test, it is not exempt.

Section 1.501(c)(3)-1(a)(2) of the Regulations states the term "exempt purpose or purposes", means any purpose or purposes specified in section 501(c)(3) of the Code.

Section 1.501(c)(3)-1(c)(1) of the Regulations states that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3) of the Code. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(d)(1)(ii) of the Regulations states that an organization is not operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. It must not be operated for the benefit of designated individuals or the persons who created it.

Rev. Rul. 67-5, 1967-1 C.B. 123, holds that a foundation controlled by the creator's family was operated to enable the creator and his family to engage in financial activities that were beneficial to them, but detrimental to the foundation. This resulted in the foundation's ownership of common stock that paid no dividends of a corporation controlled by the foundation's creator and his family, which prevented it from carrying on a charitable program commensurate in scope with its financial resources. This ruling concluded that the foundation was operated for a substantial non-exempt purpose and served the private interest of the creator and therefore, was not entitled to exemption under section 501(c)(3) of the Code.

Rev. Rul. 70-186, 1970-1 C.B. 128, in which it was found that it would be impossible to accomplish the organization's charitable purposes of cleaning and maintaining a lake without providing benefits to certain private property owners. In the quantitative sense, to be incidental, the benefit to private interest must not be substantial in the context of the overall public benefit conferred by the activity

In **Better Business Bureau v. United States, 326 U. S. 279 (1945)**, the Supreme Court stated that the presence of a single nonexempt purpose, if substantial in nature, will preclude exemption under section 501(c)(3) of the Code, regardless of the number or importance of statutorily exempt purposes. Thus the operational standard prohibiting a substantial nonexempt purpose is broad enough to include inurement, private benefit, and operations that further nonprofit goals outside the scope of section 501(c)(3).

In **P.P.L. Scholarship v. Commissioner**, 82 T.C. (1984), an organization operated bingo at a bar for the avowed purpose of raising money for scholarships. The board included the bar owners, the bar accountant, also the director of the bar, as well as two players. The board was self-perpetuating. The Court reasoned that since the bar owners controlled the organization and appointed the organization's directors, the activities of the organization could be used to the advantage of the bar owners.

In **Leon A Beeghly v. Commissioner**, 35 T.C. 490 (1960), provided that where an exempt organization engages in a transaction with a related interest and there is a purpose to benefit the private interest rather than the organization, exemption may be lost even though the transaction ultimately proves profitable for the exempt organization.

In **Best Lock Corporation v. Commissioner**, 31 T.C. 620 (1959), the court upheld the denial of an organization that loaned funds to members of the founder's family, even though the loans were repaid. The court determined that loans to family members and unsecured loans to friends of the founder and his family promoted private rather than charitable purposes.

In **Salvation Navy v. Commissioner**, T.C.M. 2002-275(2002), the court found that one of reasons why the organization did not qualify for exemption from federal income tax was because it could not prove that its net earning would not inure to the benefit of a private individual, its founder.

In **Bubbling Well Church of Universal Love, Inc. v. Commissioner**, 670 F.2d 104 (9th Cir. 1981), the court affirmed the tax court's decision that held that the organization supplied no evidence showing that the payments to its controlling members were reasonable and the court also found that the potential for abuse created by the family's control of the organization required open candid disclosure of facts.

In **Gregory v. Helvering**, 293 U.S. 465 (1935), the court held that where a transaction has no substantial business purpose other than the avoidance or reduction of Federal tax, the tax law will not regard the transaction. The doctrine of substance over form is essentially that, for Federal tax purposes, a taxpayer is bound by the economic substance of a transaction where the economic substance varies from its legal form.

Application of Law

Section 501(c)(3) of the Code and section 1.501(c)(3) -1(a) of the Regulations sets forth two main tests for qualification for exempt status. An organization must be organized and operated exclusively for purposes described in section 501(c)(3) of the Code. Because your trust instrument states purposes described in section 501(c)(3) of the Code and upon dissolution all assets will go to organizations that are exempt under section 501(c)(3) of the Code, you pass the organizational test.

You must, however, satisfy the operational test. The requirement is that an organization be operated exclusively for one or more purposes described in section 501(c)(3) of the Code and no part of its net earnings may inure to the benefit of any private shareholder or individual. The facts submitted show that your activities benefit F, the settlor/donor, and the benefits are substantial. Therefore, you are not operated exclusively for purposes described in section 501(c)(3) of the Code.

The only substantial activity of the trust has been the making of loans. Three loans were made to K, the LLC owned by F the settlor/donor, during a one year period totaling pp dollars. No evidence has been submitted to show that the loans you issued were ever discussed and approved by your Board of trustees. The only minutes submitted were from four meetings over a two year period. Three of the meeting notes covered approval of unspecified loans as well as the statements that all loans would be fully secured. One set of notes involved the approval of two small collateralized loans along with the following statement, "F is entering into a new joint venture with N [an individual] and prior loans given will be retired in the process. A new promissory note...". The minutes did not include any information indicating who was present at the meeting, the discussion of the terms of the loans, discussion of other investment options, or that a vote was taken and the loans were approved. You have not operated exclusively for section 501(c)(3) purposes as required by the Code and Regulations. Finally, your net earnings have inured to the benefit of private individuals, namely K as a result of the loans that were issued.

Private benefit has both qualitative and quantitative connotations. In the qualitative sense, to be incidental, the private benefit must be a necessary concomitant of the activity that benefits the activity at large, i.e., the benefit to the public cannot be achieved without necessarily benefiting private individuals. In Rev. Rul. 70-186 it was found that it would be impossible to accomplish the organization's charitable purposes of cleaning and maintaining a lake without providing benefit to certain private property owners. In the present case, the making of loans to disqualified persons was not required to accomplish your charitable purposes. Other investment options were available including those that you purport to have considered although there is no evidence of that in the handwritten notes that were submitted. In a quantitative sense, to be incidental, the private interests must not be substantial in the context of the overall public benefit conferred by the activity. The loans were your only substantial transactions. You made no contributions to the supported organization during your first two years; the first distribution was made midway through the third year. During the third, fourth and fifth years dd dollars was distributed to the supported organization. On the other hand, loans were made to disqualified persons/entities totaling jj dollars during your third and fourth years which 112 % of total donations. Finally, while interest payments have been paid on the loans, the payments were not made timely and were for less than the terms specified in the promissory notes. Also one of the interest payments was not even deposited in your account. Therefore, there was a substantial non exempt purpose benefiting the settlor/donor, F, through the making of loans.

Control is an important factor in determining whether an organization operates for the benefit of private interests. Similar to the organizations in P.L.L. Scholarship v. Commissioner, supra, Leon A Beeghly v. Commissioner, supra and Rev. Rul. 67-5, you are apparently controlled indirectly by F. While F is not one of your trustees, he does appoint one of the three trustees. The Bylaws provide for the removal of a trustee by a majority vote of the remaining trustees so long as one family/donor trustee votes in favor of the removal.

Since there is only one family/donor trustee and one family/donor trustee must vote in favor of the removal of a trustee and the trustee subject to the removal vote may not vote on the matter, the end result is that the one family/donor trustee is not subject to removal. This results in indirect control by the donor who appoints the family/donor trustee. While a majority vote of the three trustees is required for all other matters, there is no evidence that any votes have been taken nor that any matter related to your operations have been discussed by the Board. Finally, F, the settlor/donor, has made interest payments on the loan with M, the LLC owned by F the settlor/donor, in amounts and at times as determined by him. Not only were the interest payments not made timely, the amounts were less than required under the terms of the loan. The M loan was paid 11 months late.

To be qualitatively incidental, the private benefit to the donors must be a necessary concomitant of the activity that benefits the public at large. As indicated in **Best Lock Corporation v. Commissioner, supra** loans to other entities might also be considered as being made for the personal purposes of the founder. In your case, loans were made to entities owned by F, the settlor/donor. In Best Lock, although the loans were repaid the private benefit was still found to exist in the loan transactions. Here while the loans have been repaid, one loan was retired in conjunction with the issuance of a new larger loan that was recently repaid 11 months late. Therefore, the private benefit has been shown to not be a necessary concomitant of the activity benefiting the public at large, and the private benefit is not qualitatively incidental.

In order to be quantitatively incidental, the private benefit must be insubstantial in the context of the overall public benefit. The private benefit in this case is substantial in relation to the overall public benefit derived from your activities. F, the settlor/donor, has benefitted from the issuance of loans on an as needed basis for his various land development ventures. While the terms of the loans are not below market rates, the terms are not being adhered to by F. The distributions made to the supported organization bear virtually no relation to the supposed income stream that was to be generated by the loans. Thus, you do not satisfy the "not more than an insubstantial part of its activities" standard of section 1.501(c)(3)-1(c)(1) of the Regulations. You have a non-charitable purpose that is substantial in nature. See **Better Business Bureau v. United States, supra**.

In **Leon A Beeghly v. Commissioner, supra**, revocation of a foundation's exempt status was sustained even though the foundation emerged from the transaction without financial loss. The court noted in that case that the foundation's primary objective in entering into the transaction was to benefit the stockholders of a particular business corporation with "the objective of ultimately benefiting charities running a poor second." Thus, the test is not the ultimate profit or loss but whether, at every stage of the transaction, those controlling the exempt organization guarded its interests and dealt with related parties at arm's length. Your primary transactions did not satisfy this test. Rather, you entered into the loans with M and K, entities in which the settlor/donor and disqualified person F had a 50% and 100% ownership interest respectively. In fact, during the course of the M loan, F assumed 100% ownership interest after the withdrawal of the other 50% owner from the venture.

Similar to the organizations described in **Salvation Navy v. Commissioner, supra** and **Bubbling Well Church of Universal Love, Inc. v. Commissioner, supra**, you have not supplied evidence to show that the net earnings did not inure to the benefit of F, the donor, either directly or through ownership interests in K and M.

As indicated in Bubbling Well Church of Universal Love, Inc. v. Commissioner, supra, since your entity has the potential for abuse created by the use of the your funds through the issuance of loans to the donor, an open candid disclosure of facts is required. The substantial lack of details and documentation regarding the loans does not satisfy this requirement. Furthermore, you have failed to provide any citation, evidence or documentation to show that the loans were arm's length transactions or that the terms of the loans were enforced.

Similar to the organization described in Gregory v. Helvering, Supra, your organization has no substantial business purpose other than the reduction of federal income tax and control of funds that were supposed to be for an exempt purpose under IRC 501(c)(3).

Reg. 1.501(c)(3)-1(c) (2) clarifies that an organization is not operated exclusively for exempt purposes if its net earnings inure to the benefit of private individuals. Based on the information submitted your earnings inure to the private interest of F and you are not operating exclusively for purposes described in Section 501(c)(3). The only significant transactions have been loans to the settlor/donor, F, through ownership in M and K. The transactions were executed with no evidence of participation or vote by the trustees. In conclusion, the primary purpose results in private benefit and inurement to F, the settlor/donor. Accordingly, you serve a private purpose rather than a public purpose.

DETERMINATION – ISSUE 1

Based on the information provided in your application and supporting documentation, we conclude that you are not operated exclusively for purposes described in section 501(c)(3) of the Code. You have not shown that your activities are exclusively for purposes described in section 501(c)(3) of the Code.

ISSUE 2 - IRC 509(a)(3)**Introduction**

We have also considered your application for supporting organization status (non-private foundation status) under section 509(a)(3) of the Code in the event that you would qualify for exemption under section 501(c)(3). Our conclusion regarding your private foundation classification under section 509(a)(3) of the Code is based on a number of factors discussed in the following material.

Section 509(a)(3) of the Code provides that the term "private foundation" does not include an organization which:

(A) is organized, and at all times thereafter is operated, exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more specified organizations described in section 509(a)(1) or (2),

(B) is operated, supervised, or controlled by or in connection with one or more organizations described in section 509(a)(1) or (2), and

(C) is not controlled directly or indirectly by one or more disqualified persons (as defined in section 4946) other than foundation managers and other than one or more organizations described in section 509(a)(1) or (2).

Section 509(a)(3)(A), in effect, describes as a public charity, an organization which is organized and at all times thereafter is operated, exclusively for the benefit of, to perform the functions of, or carry out the purposes of one or more specified organizations described in sections 509(a)(1) or 509(a)(2). In our discussion of these issues, we are cognizant of the fact that at all times you are asserting qualification under section 509(a)(3) under the "operated in connection with" relationship provided in section 1.509(a)-4(i) of the Income Tax Regulations.

For an organization to qualify as a supporting organization it must pass the organizational and operational test (509(a)(3) (A)), relationship test (509(a)(3)(B)) and a control test (509(a)(3)(C)). Your organization does not pass the operational test, the relationship test, and control test.

Organizational Test

Section 509(a)(3)(A) of the Code provides that, in order to qualify under section 509(a)(3) an organization at all times thereafter is operated, exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more specified organizations described in section 509(a)(1) or (2).

Reg. 1.509(a)-4(b)(1) provides that in order to qualify as a supporting organization, an organization must be both organized and operated exclusively "for the benefit of, to perform the functions of, or to carry out the purposes of" one or more specified publicly supported organizations. If it fails to meet either the organizational test or operational test, it cannot qualify as a supporting organization.

Reg. 1.509(a)-4(c)(1) provides that a supporting organization's governing instrument (i.e. trust document) must meet the following requirements:

- It must limit the organization's purposes to one or more purposes set forth in IRC 509(a)(3)(A);
- It must not expressly empower the organization to engage in activities that are not in furtherance of the authorized purposes;
- It must state the specified publicly supported organizations on whose behalf the organization is to be operated; and
- It cannot expressly empower the organization to support or benefit any organization other than the specified publicly supported organizations.

However, there is some flexibility permitted by the Regulations, including for organizations seeking to satisfy the "operated in connection with" relationship test ("test 3") of section 509(a)(3). The flexibility permitted in the Regulations for supporting organizations seeking to meet the test 3 relationship test is conditioned on appropriate language in the governing instrument.

Reg. 1.509(a)-4(d)(4)(i)(a) provides that a supporting organization will not be disqualified merely because its organizing document permit a supported organization designated by class or purpose, rather than by name, to be substituted for the supported organization designated by name in the articles, but only if the substitution is conditioned on an event "beyond the control" of the supporting organization, such as loss of exemption.

Reg. 1.509(a)-4(d)(4)(i)(b) provides that a supporting organization may operate for the benefit of a beneficiary organization which is not a publicly supported organization, but only if such supporting organization is currently operating for the benefit of a publicly supported organization and the possibility of its operating for the benefit of other than a publicly supported organization is a remote contingency.

Reg. 1.509(a)-4(d)(4)(i)(c) provides that the articles may permit the supporting organization to vary the amounts of its support between different supported organizations, so long as the amounts meet the requirements of the integral part test of Reg. 1.509(a)-4(i)(3) with respect to at least one beneficiary. A third exception primarily deals with support of a beneficiary that is not publicly supported, and is not applicable to this situation.

In Quarrie Charitable Fund v United States, 603 F.2d 1274 (7th Cir., 1979), the trust document allowed the trustee to transfer the income to a supported organization other than the designated charity when, in the trustee's sole discretion, the charitable uses would become unnecessary, undesirable, impractical, or no longer adapted to the needs of the public. The court found that the language failed the organizational requirement of Reg. 1.509(a)-4(d)(4)(i)(a). The court explained that the problem was not that the charitable use may become impractical or undesirable, but that in the trustee's discretion, such use may become impractical or undesirable etc. In contrast, the Regulations establish objective standards of when the charitable recipient may be changed.

In **Trust Under the Will of Bella Mabury v. Commissioner**, 80 R.C. 718, 1983, the U.S. Tax Court applied these regulations in concluding that an organization was not a supporting organization because the organizational documents of the entity expressly empowered it to benefit organizations other than specified publicly supported organizations.

Application of Organizational Test

You are not organized exclusively for the benefit of specified publicly supported organizations as required by section 509(3)(a)(A). Your trust document states in Part 2.1.2 that your primary supported charitable organization is the W in T, known as the C, a church. The trust document also states that you will support other churches and their activities that are affiliated with the D, a denomination. Part 1.2 of the trust document states that the "Foundation Trust is organized to support Christian religious ministries. The primary mission of the supported organization is to preach, teach and demonstrate the Gospel of Jesus Christ through various humanitarian acts such as feeding, clothing, educating and providing shelter for children, widows and orphans locally that may otherwise not get such needs satisfied if not for the funding by this Foundation Trust. It is the goal of the Trust to operate within the church community in any geographical area in which the Trustees reside." Part 2.1.3 provides for replacement organizations if the specified supported organization ceases to exist or becomes a non-qualified recipient. The document also states, "the trustees in their sole judgment may replace any organization which fails to promote the purposes of the Trust." Part 2.2.1 states that the trust will extend financial aid or assistance to qualified charitable organizations. Part 2.3 defines the term charitable organizations to mean organizations in the United States or in a foreign country and qualifying under the Internal Revenue Code as organized and operated exclusively for charitable purposes. An amendment to trust was executed in August 2008. Part 2.1.2 has been revised to read "Primary Supported Charitable Organizations W in T known as: C [a church] affiliated with the E [an international church]."

Your trust instrument permits trustees, in their sole judgment, to replace any organization which fails to promote the purposes of the trust. This is in violation of both the regulations and **Quarrie Charitable Fund v United States, supra**. Also, the trustees are authorized to make distributions to entities or organizations other than the specified supported organization which again is in violation of the regulations and **Trust Under the Will of Bella Mabury v Commissioner, supra**.

Conclusion

Based on the facts you have failed to meet the organizational test of Section 509(a)(3)(A). As described in Section 1.509(a)-4(c)(1) of the Regulations, your organizational document, the trust instrument, cannot expressly empower the organization to support or benefit any organization other than the specified publicly supported organizations. Also, it cannot permit substitution of supported organizations unless the substitution is conditioned upon an event beyond your control. Therefore, you are not "operated in connection with" the supported organization.

Operational Test

Section 509(a)(3)(A) of the Code provides that, in order to qualify under section 509(a)(3) an organization at all times thereafter is operated, exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more specified organizations described in section 509(a)(1) or (2).

Reg. 1.509(a)-4(b)(1) provides that in order to qualify as a supporting organization, an organization must be both organized and operated exclusively "for the benefit of, to perform the functions of, or to carry out the purposes of" one or more specified publicly supported organizations. If it fails to meet either the organizational test or operational test, it cannot qualify as a supporting organization.

Reg. 1.509(a)-4(e)(1) provides that a supported organization will be regarded as "operated exclusively" to support one or more specified public supported organization only if it engages solely in activities which support or benefit the specified publicly supported organizations.

Application of Operational Test

You are not operated exclusively for the benefit of specified publicly supported organizations as required by section 509(3)(a)(A). Your only major transactions have been the making of loans to disqualified persons, primarily F, the settlor/donor. The terms of the loans were not enforced as evidenced by the loan with M, the LLC owned by F, that was repaid 11 months late.

Relationship test

Section 509(a)(3)(B) of the Code provides that, in order to qualify under section 509(a)(3), an organization must be "operated, supervised, or controlled by," "supervised or controlled in connection with," or "operated in connection with" one or more publicly supported organizations.

Section 1241(c) indicates that CHARITABLE TRUSTS WHICH ARE TYPE III SUPPORTING ORGANIZATIONS shall not be considered to be operated in connection with any organization described in paragraph (1) or (2) of section 509(a) of such Code solely because—

- (1) it is a charitable trust under State law,
- (2) the supported organization (as defined in section 509(f)(3) of such Code) is a beneficiary of such trust, and
- (3) the supported organization (as so defined) has the power to enforce the trust and compel an accounting.

CHARITABLE TRUSTS WHICH ARE TYPE III SUPPORTING ORGANIZATIONS-shall take effect-

- (A) in the case of trusts operated in connection with an organization described in paragraph (1) or (2) of section 509(a) of the Internal Revenue Code of 1986 on the date of the enactment of this Act, on the date that is one year after the date of the enactment of this Act, and (B) in the case of any other trust, on the date of the enactment of this Act.

Reg. 1.509(a)-4(f)(3)(i) provides that the supporting organization will be responsive to the needs or demands of one or more publicly supported organizations; and (ii) the supporting organization will constitute an integral part of, or maintain a significant involvement in, the operations of one or more publicly supported organizations.

Reg. 1.509(a)-4(i)(1)(i) provides that generally a supporting organization will be considered as being "operated in connection with" one or more publicly supported organizations only if it meets the "responsiveness test" and the "integral part test."

Reg. 1.509(a)-4(i)(2)(i) provides that a supporting organization will meet the "responsiveness test" if the organization is responsive to the needs or demands of the publicly supported organizations.

Reg. 1.509(a)-4(i)(2)(iii) provides that one way a supporting organization may establish "responsiveness" is by satisfying the following three requirements: (a) The supporting organization is a charitable trust under State law; (b) Each specified publicly supported organization must be a named beneficiary under such charitable trust's governing instrument; and (c) The beneficiary organization has the power to enforce the trust and compel an accounting under State law.

Reg. 1.509(a)-4(i)(3)(i) provides that a supporting organization will be considered to meet the "integral part test" if it maintains a significant involvement in the operations of one or more publicly supported organizations and such publicly supported organizations are in turn dependent upon the supporting organization for the type of support which it provides. A supporting organization may satisfy the "integral part test" by meeting either the "functional support" test, also known as the "but-for test" or the "attentiveness" test.

Reg. 1.509(a)-4(i)(3)(iii)(a) provides that a supporting organization will meet the "attentiveness" test if the supporting organization makes payments of substantially all of its income to or for the use of one or more publicly supported organizations, and the amount of support received by one or more of such publicly supported organizations is sufficient to insure the attentiveness of such organizations to the operations of the supporting organization. In addition, a substantial amount of the total support of the supporting organization must go to those publicly supported organizations which meet the attentiveness requirement of this subdivision with respect to such supporting organization. Generally, the amount of support received by a publicly supported organization must represent a sufficient part of the organization's total support so as to insure such attentiveness. However, if such supporting organization makes payments to, or for the use of, a particular department or school of a university, hospital or church, the total support of the department or school shall be substituted for the total support of the beneficiary organization.

Reg. 1.509(a)-4(i)(3)(iii)(b) provides an exception to the general "attentiveness" test for earmarking. Even where the amount of support received by a publicly supported beneficiary organization does not represent a sufficient part of the beneficiary organization's total support, the amount of support received from a supporting organization may be sufficient to meet the requirements for "attentiveness" if it can be demonstrated that in order to avoid the interruption of the carrying on of a particular function or activity, the beneficiary organization will be sufficiently attentive to the operations of the supporting organization. This may be the case where either the supporting organization or the beneficiary organization earmarks the support received from the supporting organization for a particular program or activity, even if such program or activity is not the beneficiary organization's primary program or activity so long as such program or activity is a substantial one.

Revenue Ruling 76-208 states that in order to satisfy the "substantially all" requirement of section 1.509(a)-4(i)(e)(iii)(a) of the Income Tax Regulations, a supporting organization must distribute 85 percent of its income to or for the uses of one or more publicly supported organizations.

Notice 2006-109, 2006-51 I.R.B. 1121, This notice provides interim guidance regarding the application of certain requirements enacted as part of the Pension Protection Act of 2006, Pub. L. No. 109-208, 120 Stat. 780 (2006) ("PPA"), that affect supporting organizations. As provided by sections 1241 and 1243 of the PPA, the existing integral part test regulations contained in section 1.509(a)-4(i)(3) will be amended. Until final guidance is issued that defines these organizations must meet the "payout/responsiveness requirements of the current regulations.

Application of Relationship Test

In general, supporting organizations have been identified by the type of relationship they have with their supported IRC 509(a)(1) or (2) organizations. Under the PPA of 2006, supporting organizations are classified into Type I, Type II, or Type III supporting organizations. These names merely reflect the existing three relationships with supported organizations described in the current regulations. Type I supporting organizations are operated, supervised, or controlled by one or more IRC 509(a)(1) or (2) organizations. Type II supporting organizations are supervised or controlled in connection with one or more IRC 509(a)(1) or (2) organizations. Type III supporting organizations are operated in connection with one or more IRC 509(a)(1) or (2) organizations.

On schedule D you indicated that you are a Type III supporting organization which is "operated in connection with" your supported organization, C.

Effective August 17, 2006, an alternative responsiveness test applicable to charitable trusts has been eliminated by Section 1241(c) of the Pension Protection Act (PPA). However, charitable trusts that met the operated in connection with test on August 17, 2006 could continue to rely on the alternative responsiveness test until August 17, 2007. After that date such trusts must meet the responsiveness test described above to continue to qualify as Type III supporting organizations.

You meet the "responsiveness test" requirements of Reg. 1.509(a)-4(i)(2)(iii) since you are a charitable trust under State law, the supported organization was a named beneficiary in the trust instrument, and the supported organization had the power to enforce the trust and compel an accounting under State law. Thus, the "alternative" responsiveness test was satisfied at that time. This alternative responsiveness test option has since been eliminated, per the Pension Protection Act of 2006.

After August 17, 2007, the responsiveness test must be met in one of three ways and as a result the supported organization must have a significant voice in the operations and use of the assets of the supporting organization. You meet the responsiveness test because one of your Trustees is appointed by supported organization; however, no evidence has been submitted demonstrating that V, trustee/pastor, has a significant voice in the operations and use of your assets. You do not meet the responsiveness component of the relationship test.

The integral parts test is the second component of the relationship test, it may be met through one of two methods: the payout/attentiveness requirement or the "but for" requirement. You indicated that you are seeking to meet the payout/attentiveness requirement under the integral parts test. You stated that you pay substantially all (85%) of your adjusted net income to or for the use of the supported organization; however, based upon the financial information submitted you have not paid 85% of your income to the supported organization. You also stated that you meet the Group I criteria from the guidesheet indicating that your payout to the supported organization is large enough to ensure the attentiveness of the supported organization to your operations. In order to meet the Group 1 criteria you must demonstrate that your support is more than 10% of the supported organization's total support for the year; however, you have not done so. You submitted a letter from the supported organization stating that they believe that you meet the Group 1 criteria, which you stated was all that was required. You also stated that your support is more than 10% of a department of a church; however, the program that you allegedly supported has now been integrated into the church and is no longer a separate program. You did not submit the total amount of revenue that the supported organization receives each year to support your contention that you provide at least 10% of the supported organization's total support nor have you demonstrated that you are supporting a "department" of the church in an amount greater than 10%.

Conclusion

Based upon the facts you have not satisfied the relationship test of Section 509(a)(3)(B) because you do not meet the responsiveness test or the integral parts test.

Control Test

Section 509(a)(3)(C) of the Code, in effect, provides that public charity status under section 509(a)(3) is precluded for an organization that is controlled directly or indirectly by one or more disqualified persons (as defined in section 4946) other than foundation managers and other than one or more organizations described in paragraph (1) and (2).

Section 4946(a) of the Code defines a disqualified person as a substantial contributor to the foundation. Section 4946(a)(1)(C) includes in its definition of a substantial contributor an owner of more than 20%, (i) the total combined voting power of a corporation, (ii) the profits interest in a partnership, or (iii) the beneficial interest of a trust or unincorporated enterprise which is a substantial contributor to the Foundation.

Section 1.509(a)-4(j)(1) of the Regulations provides that if a person who is a disqualified person with respect to a supporting organization, such as a substantial contributor to the supporting organization, is appointed or designated as a foundation manager of the supporting organization by a publicly supported beneficiary organization to serve as the representative of such publicly supported organization, then for purposes of this paragraph, such person will be regarded as a disqualified person rather than as a representative of the publicly supported organization.

An organization will be considered "controlled," for purposes of section 509(a)(3), if the disqualified persons, by aggregating their votes or positions of authority, may require such organization to perform any act which significantly affects its operations or may prevent such organization from performing such act. This includes, but is not limited to, the right of a substantial contributor or his spouse to designate annually the recipients, from among the publicly supported organizations of the income attributable to his contribution to the supporting organization.

Rev. Rul. 80-207, 1980-2 C.B. 193, held that for purposes of classification as a supporting organization under section 509(a)(3) of the Code, an employee of a corporation owned (over 35 percent) by a substantial contributor, a disqualified person, will be considered under the indirect control of a disqualified person for purposes of the control test.

Application of Control Test

You are controlled by a three member Board of trustees, one of which is appointed by the settlor/donor, F. It appears that H, the family trustee appointed by F, is virtually safe from removal based upon the provisions found in the trust instrument. All other decisions made by the Board require a simple majority vote. No significant Board meeting minutes have been submitted to demonstrate that the Board of trustees controls you. It does appear that F, the settlor/donor, has indirect control over the use of the organization's assets due to the manner in which the loans made to him are administered. Another indication of indirect control is the fact that the trustee that he appoints must vote in favor of the removal of the other trustees but H himself cannot be removed since he would have to vote in favor of his own removal which is not permitted. Finally, the trust instrument specifically states that no loans may be made to donors; however, three such loans have been made. Therefore, your organization is indirectly controlled by disqualified persons.

Conclusion

Based on the facts of the case, the trust was controlled by disqualified persons. Section 509(a)(3)(C) of the Code, in effect, provides that public charity status under section 509(a)(3) is precluded for an organization that is controlled directly or indirectly by one or more disqualified persons (as defined in section 4946)

DETERMINATION – ISSUE 2

Based on our analysis of your actual and proposed activities, you have failed the organizational test, the relationship test and the control test. As a result of our analysis, and in light of the applicable law, we have determined you do not qualify for exclusion from private foundation status under section 509(a) (3) of the Code.

CONCLUSION

In conclusion, we have determined you do not qualify for tax exemption as an organization described in section 501(c)(3) of the Code. Even if we determined that you were described in section 501(c)(3), you would be a private foundation and not a supporting organization under section 509(a)(3) of the Code.

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination. If your statement does not provide a basis to reconsider our determination, we will forward your case to our Appeals Office. You can find more information about the role of the Appeals Office in Publication 892, *Exempt Organization Appeal Procedures for Unagreed Issues*.

Types of information that should be included in your appeal can be found in Publication 892. These items include:

1. The organization's name, address, and employer identification number;
2. A statement that the organization wants to appeal the determination;
3. The date and symbols on the determination letter;
4. A statement of facts supporting the organization's position in any contested factual issue;
5. A statement outlining the law or other authority the organization is relying on; and
6. A statement as to whether a hearing is desired.

The statement of facts (item 4) must be declared true under penalties of perjury. This may be done by adding to the appeal the following signed declaration:

"Under penalties of perjury, I declare that I have examined the statement of facts presented in this appeal and in any accompanying schedules and statements and, to the best of my knowledge and belief, they are true, correct, and complete."

Your appeal will be considered incomplete without this statement.

If an organization's representative submits the appeal, a substitute declaration must be included stating that the representative prepared the appeal and accompanying documents; and whether the representative knows personally that the statements of facts contained in the appeal and accompanying documents are true and correct.

An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you during the appeal process. If you want representation during the appeal process, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. You can find more information about representation in Publication 947, *Practice Before the IRS and Power of Attorney*. All forms and publications mentioned in this letter can be found at www.irs.gov, Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to appeal as a failure to exhaust available administrative remedies. Code section 7428(b)(2) provides, in part, that a declaratory judgment or decree shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted all of the administrative remedies available to it within the IRS.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848, and any supporting documents to the applicable address:

Mail to:

Internal Revenue Service
EO Determinations Quality Assurance
Room 7-008
P.O. Box 2508
Cincinnati, OH 45201

Deliver to:

Internal Revenue Service
EO Determinations Quality Assurance
550 Main Street, Room 7-008
Cincinnati, OH 45202

You may fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Robert Choi
Director, Exempt Organizations
Rulings & Agreements

Enclosure: Publication 892